Lew Decl. Exs. 4-5. The collocation data, however, fail to capture the significant competition from carriers that bypass Verizon's facilities entirely. Sprint likewise recognized that collocation triggers "can be inadequate and unreliable indicators of competition" because "[m]any alternative providers of special access services do *not* collocate in the ILEC end office (for example, a neighboring ILEC that overbuilds its local franchise, or a cable or electric power company that uses its own plant to provide telecommunications services)." Sprint 10 (emphasis in original). *See also* SBC Casto Decl. ¶ 11; Iowa/Valor 18-19.

Similarly, SBC highlighted the increased use of carrier hotels, which are ignored by the collocation-based pricing flexibility triggers. SBC Casto Decl. ¶¶ 28-35. Because such hotels often are located in the same building as a competing carrier's optical backbone hub or gateway location, collocating carriers are able to gain access to all of the other fiber optic transmission networks that collocate in or connect with this hotel. As a result, carriers collocating in the hotel obtain direct access to competitive transport networks, as well as indirect access to any ILEC central office or tandem office that is connected to those alternative transport networks. SBC provided several examples of carrier hotels in SBC's territory. *Id.* ¶ 32.

Carrier hotels likewise are prevalent in MSAs throughout Verizon's Territory. To provide just a few examples[12]:

- 2401 Locust Street, Philadelphia, Pennsylvania. Connectivity in this building is "abundant" due to its proximity to "the AT&T central office and the B&O Railroad fiber routing." The building has over 44,000 square feet. Tenants at 2401 Locust include AT&T, Verizon, Level 3, Abovenet, MCI, WilTel, XO, Exelon, Voice Systems, and Cavalier. *See* Lew Reply Decl. ¶ 22, Ex. 5(a) (Attachment B hereto).

- 32 Avenue of Americas, New York, NY. This building is a "true carrier-neutral co-location facility" and operates as an "interconnection powerhouse" "in the heart of New York City." The building offers access to wireless and terrestrial communications service providers, which provide "true business continuity to both the Enterprise user and

[12] Additional examples are discussed in Appendix A to the Lew Reply Declaration.

> telecom service provider." Tenants include AboveNet, ALS, AT&T, Bell Canada, Cablevision/Lightpath, Cogent Communications, Con Edison Communications, Digit Global, DirecTV, Dreamxotic, FiberNet, Genesis, Global Crossing, Gigabeam, Keyspan Communications, Level 3, Lexant, Looking Glass, NyserNet, OnFiber Communications, PPL Telecom, Prodigy, Qwest, RAI Networks, RCN, Time Warner Telecom, T-Mobile/Voicestream, T-Systems, Towerstream, Tyco Telecommunications, XO, and Yipes Communications. *See* Lew Reply Decl. ¶ 22, Ex. 5(b).

The widespread availability and use of carrier hotels underscores the need to revamp the existing pricing flexibility triggers.

Verizon also submitted independent third party data from GeoTel and GeoResults regarding fiber networks deployed and buildings lit by alternative providers. Verizon 27, Table 2; *see also* SBC Casto Decl. ¶¶ 12-20; 34-35. In addition, Verizon produced detailed, publicly available information regarding more than 30 carriers' local high-capacity networks. Verizon 27-28; Lew Decl. ¶¶ 14-23; Lew Decl. Exs. 4, 5, 22N, 22T & Appendix B (showing that competitive providers have over 55,000 local route miles and use their own fiber to connect to over 31,400 buildings across the country); *see also* SBC Casto Decl. Figure 1 (showing that there has been a nearly 200 percent increase in competitive alternatives from 1999 to 2004); Iowa/Valor 15-18 (providing evidence of competitive providers overbuilding and using their own facilities to compete directly with these mid-size LECs for special access services). Verizon's comments also demonstrated that cable and fixed wireless providers are winning special access customers in significant numbers from wireline providers. Verizon 29-33; Lew Decl. ¶¶ 25-44; *see also* SBC 16-20.

Moreover, Verizon described how it selected a competitive provider of high-capacity services in 19 of 28 out-of-region areas. Verizon 33-34; *see generally* Pilgrim Decl. And finally, Verizon highlighted the intense competition to serve enterprise customers, explaining that, in an analysis of 4 MSAs, 10 of the largest users of telecommunications services purchased less than 7 percent of their telecommunications services from Verizon. Bruno Decl. ¶¶ 18-34.[13]

B. In Contrast, The Proponents Of Intrusive Regulation Have Filed Nothing More Than Naked Assertions That BOC Special Access Is Their Only Choice For Some Services In Certain Areas.

Although the Commission requested that all parties submit evidence about the degree of competition, supply of special access services, and costs of self-deployment, *NPRM* ¶¶ 82, 100-101, the proponents of intrusive rate regulation have failed to do so.[14] Not one of these parties submitted network maps, lists of buildings served, or any other probative evidence, all of which is within their control. Their silence requires the Commission to presume that this evidence would undermine their arguments and precludes the Commission from granting the relief they request. Indeed, the Commission must infer that data that competitors obviously maintain but have purposely withheld are unfavorable to them. Verizon 24 n.15 *citing Int'l Union, UAW v. NLRB*, 459 F.2d 1329, 1336 (D.C. Cir. 1972) ("[W]hen a party has relevant evidence within his control which he fails to produce, that failure gives rise to an inference that the evidence is unfavorable to him.").

In any event, the competitive providers' actions in the marketplace belie their unsupported assertions of a monopoly. For example:

Time Warner Telecom states (at 1-4) that there is an "immediate need" to reinitialize ILEC special access rates. Yet it has told investors and the public that "[t]he majority of our

[13] BellSouth submitted evidence that competing carriers market share are increasing and that such carriers currently provision 79% of OCn services and 55% of DS3 services. BellSouth 23-37. Iowa Telecom likewise explained that the Iowa Utilities Board found that it has *less* than 50 percent market share due to vigorous competition from other providers that have constructed their own networks and bypassed Iowa Telecom's facilities entirely. Iowa/Valor 16-17.

[14] SAVVIS and Broadwing were the only non-ILEC commenters to submit any confidential data, which was limited to the percentage of special access circuits purchased from ILECs versus non-ILECs.

revenue continues to be derived from services provided to our customers exclusively through our own network facilities and that "[i]n instances where we need services from ILECs to connect our remote customers to our vast fiber network, we purchase those under special access tariffs or under agreements with the ILECs." Lew Reply Decl. ¶ 17; *Id.* Ex. 1(a). Time Warner Telecom also announced "solid" first quarter 2005 results, including 16 percent enterprise revenue growth and a 21 percent increase in directly on-net buildings, to nearly 5300, *id.*,(in addition to 14,576 buildings that are served indirectly). *See* Lew Decl. ¶ 22(cc); Lew Reply Decl. Ex. 1(c).

SAVVIS (at 10-24) urges the Commission to address the ILECs' "exclusionary" pricing practices. Given that SAVVIS purchases most of its access services from non-ILECs, its complaints regarding exclusionary pricing are moot since it does not avail itself to the same. To the contrary, SAVVIS's purchases demonstrate that there are clear alternatives to Verizon's services and that competition in the provision of special access services is disciplining special access rates, terms, and conditions. Further confirming that SAVVIS has not been harmed by any (nonexistent) exclusionary practices, SAVVIS reports to investors that it is in a "stable financial position" with $55.4 million in cash, that it enjoyed a "gross margin of $178.9 million on revenue of $616.8 million in 2004" (an increase of more than $350 million from 2003), that its profit for the first quarter of 2005 grew 77 percent, to $53.1 million, compared to the first quarter in 2004, and that it had earnings before interest, taxes, depreciation and amortization of $14.4 million in 2004, a $15.6 million improvement from 2003. Lew Reply Decl. ¶ 18; *Id.* Exs. 2(a-d).

PAETEC, which leases ILEC special access for 95 percent of its connections to end users, complains (at 6, 10-23) about excessive special access rates. But it also states that its market strategy (presumably including the use of ILEC special access) has worked "extremely well" and that it has never encountered financial difficulties, and its CEO recently announced that PAETEC enjoyed "year-over-year access line growth of nearly 33 percent" and possesses "financial stability." Lew Reply Decl. ¶ 19; *Id.* Ex 3(a). PAETEC also is expanding aggressively into new markets. *Id.*, Exs. 3(b-d).

XO claims regulation is needed to reduce current special access rates. Yet it tells investors and customers that, "[w]ith our extensive array of facilities and fiber networks in local markets across the country, XO can provide a wide range of cost-effective UNE transport and UNE-P alternative solutions to carriers." Lew Reply Decl. ¶ 20; *Id.* Ex. 4(a). It also provides fixed wireless broadband services to "one of the national mobile wireless carriers" for "primary network connectivity and redundancy." *Id.* Ex. 4(b). And, in the first quarter of 2005, XO's voice revenues "increased $55.4 million or 42.3% compared to the same period in 2004," while its data revenues "increased $15.4 million or 16.6%." *Id.*

In short, actual marketplace evidence of expanding markets and increased revenues undermines these carriers' claims that intrusive regulation of special access rates is needed to head off pending disaster. Like any firm in any market, these highly successful competitors would like to pay even lower rates for inputs than they already do. Given widespread competition in the provision of special access services, however, that is a matter between each of these companies and their suppliers; it is not an issue meriting Commission intervention.

C. **Verizon Does Not Prevent Customers From Moving To Other Special Access Providers.**

Notwithstanding the multitude of competitive alternatives, some commenters claim that ILECs make it administratively and financially difficult to migrate existing special access facilities to alternative providers by "locking up" business or limiting the ability of carriers to migrate circuits within a given time frame. In Verizon's case, these claims are misplaced.

1. Claims that Special Access Discount Plans Are Exclusionary Have No Merit.

Verizon's discount plans do not prevent wholesale customers from purchasing services from other carriers or from using their own facilities, notwithstanding the assertions of several proponents of intrusive regulation, which claim that some term and volume discount plans allegedly foreclose competition. Their concerns ring hollow, as discussed below. Before addressing their specific claims, however, it is worth noting that their own arguments confirm that the terms and conditions in Verizon's discount plans are disciplined by competition.

In particular, Broadwing/SAVVIS (at 27) point out that, "in a competitive market," the ILECs' terms and conditions would "be comparable to those offered by their competitors."[15] They suggest this is not the case, contending (at 26-27) that (1) competitors "typically do not charge a termination penalty" if a circuit is "terminated before the term of the contract, [as] long as overall spend remains at or above the committed amount," whereas ILECs "require customers to commit to circuit-specific three-to-five year contracts," and (2) competitors "permit [companies] to commit to one-year contracts on a circuit-by-circuit basis," while ILECs supposedly require "three, five, or seven-year contracts that cover all of the special access circuits purchased within the ILEC's region." In reality, Verizon East's Commitment Discount Plans and Verizon West's Term Volume Plans (two varieties of the many discount plans offered by Verizon) are extremely popular precisely because they permit customers to terminate, add, and move circuits without liability, as long as the overall in-service channel terminations remain at or above the committed amount and a circuit is not removed prior to expiration of the applicable minimum service period. And Verizon, just like its competitors, also offers circuit-

[15] Broadwing/SAVVIS (at 27) also assert that ILEC service levels are lower than competitors', but they offer no means of determining the basis for this claim, which therefore should be dismissed.

specific discounts for one-year term commitments (as well as for longer terms). *See generally* Lew Decl. ¶¶ 65-67. By Broadwing/SAVVIS's own admission, therefore, the terms and conditions in Verizon's discount plans reflect the intensity of special access competition.

The most widely voiced concerns about allegedly exclusionary conditions do not apply to Verizon's discount plans. Several parties, for example, criticize plans that condition discounts on the customer's terminating service with competitors. AT&T 8, Broadwing/SAVVIS 24, ATX *et al.* 35-38. None of Verizon's discount plans contains such a requirement.[16] And some parties assert that ILECs improperly tie discounts on routes where no competitive facilities exist to requirements to purchase special access from the ILEC on competitive routes, Broadwing/SAVVIS 23-24, or bundle supposedly less competitive and more competitive capacity levels, *see* CompTel 32. Once again, regardless of whether such requirements are in fact unreasonable, Verizon does not condition the availability of its discounts in this manner.[17]

The only concern expressed about Verizon's discount plans is that some of those plans require the customer to maintain for the term of the plan a volume level equivalent to 90 percent of the relevant circuits it had in service with Verizon at the beginning of the plan. *See* CompTel

[16] Similarly, some commenters claim it is improper to condition discounts on not exceeding a set percentage of access circuits that are obtained as UNEs rather than special access. *See, e.g.*, ATX *et al.* 37-38. Verizon does not currently provide additional discounts for customers' commitment not to purchase UNEs, but such a provision would be perfectly legitimate. Because UNE rates typically are set below any realistic measure of cost, all such a provision would do is ensure that, in exchange for the benefit to the customer of significant discounts on its special access purchases, the carrier providing those services would have a greater opportunity to recover the costs of serving the customer.

[17] As discussed below, some of Verizon's discount plans – like those of its competitors – require customers to commit a percentage of their initial special access channel terminations in-service with Verizon for the duration of the plan in order to receive the discounts offered under the plan. Yet, these plans contain comparable discounts to plans that do not contain such requirements. *See* Lew Decl. ¶ 67. Likewise, some of Verizon's contract tariffs apply to a range of special access services at different capacity levels. But these contracts tariffs are negotiated with individual customers and voluntarily entered into in exchange for discounts beyond those offered in Verizon's general term and volume discount plans. They are hardly coercive or exclusionary.

19-20 (raising specific concerns about Verizon West's DS1 Eight and Ten Year Term Volume Plan), WilTel 13-15 (generally objecting to the 90 percent requirement in Verizon East's Commitment Discount Plan).[18] But these plans provide a procompetitive, alternative discount vehicle.

As an initial matter, there are two points that bear emphasis: (1) both of these plans are entirely optional, since Verizon offers a wide range of other plans that do not have a minimum volume commitment yet contain comparable discounts, and (2) both of these plans were developed in response to customer requests for more flexibility to drop, add, and move circuits without liability, and they are quite well-received for this very reason. *See* Lew Reply Decl. ¶¶ 4-14. These plans, in short, are a healthy response to marketplace competition and provide substantial consumer benefits.

CompTel nonetheless claims that the Eight and Ten Year Term Volume Plan is exclusionary. In particular, CompTel complains that this Plan requires the customer to commit 90 percent of its DS1 channel terminations then in-service with Verizon for 8 or 10 years, increases the required commitment if the customer's volume increases, and allegedly includes substantial shortfall charges. These aspects of the plan are not exclusionary.

First, this plan is just one of many options for DS1 discounts. In fact, Verizon offers a number of shorter duration DS1 Term Volume Plans (which are available for terms of one, two, three, or five years), which contain none of the conditions that CompTel complains about yet still offer competitive discounts. *Id.* ¶ 11. In particular, those shorter-term plans permit the customer

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[18] AT&T asserts (at 6-7) that the Commission should prohibit conditioning volume discounts on a customer's agreement to maintain a percentage of its previous purchase level, because in a "declining market," this is equivalent to an unlawful growth discount. Special access demand is still growing, as is the business of many of Verizon's carrier customers. Moreover, no carrier is forced to sign up for a commitment discount plan, for the reasons stated in the text.

to establish whatever commitment level it wishes, regardless of how many lines it has in place with Verizon. *Id.* What's more, the shorter-term plans do not raise the commitment level automatically as the volume increases; the customer decides how many circuits to commit at all times. *Id.* The shorter-term plans also have extremely reasonable shortfall provisions. Every 12 months, Verizon determines whether the customer's number of lines in service meets or exceed the committed amount. *Id.* A customer may miss its commitment by up to 3 percent without paying any penalty. If it misses the commitment by more than 3 percent, shortfall penalties apply for only 4 months, not the full 12 months. *Id.*

Second, the Eight and Ten Year Plan does not really require a customer to subscribe for a full eight- or ten-year term. This Plan contains a "time in service credit," which, for example, enables a customer to sign up for the Plan for only three or five years if it has completed five years' uninterrupted service under a Term Volume Plan. *Id.* ¶12. Accordingly, the customer can receive greater discounts than are available for a three- or five-year commitment, even though that is all that is really required. In exchange, Verizon asks customers to commit 90 percent of their then in-service DS1 channel terminations with Verizon. *Id.* While CompTel complains that this commitment is increased at the annual review if the customer's volume has increased, it does not acknowledge that the customer receives discounts on each line under the plan (including those above the commitment) from the date it is turned up, even though the commitment is only increased on the annual review date. And CompTel ignores the fact that it is up to the customer to decide whether or not it wants to add circuits under the plan (or, for example, to build its own facilities or use another provider).

Third, while CompTel believes the shortfall charges are excessive, it neglects to point out that, even if a customer has failed to meet the commitment level for an entire year, the Eight and

Ten-Year Term and Volume Plan shortfall liability only is calculated for the six months prior to the annual review date. *Id.* ¶ 13. Thus, even if the customer fails to meet its revenue commitment for an entire year, it is only responsible to pay shortfall for half of the period. *Id.*

Finally, CompTel fails to mention that there is an ironclad rate stability guarantee, so that a customer may terminate without liability if rates increase other than due to action by the FCC. *Id.* ¶ 14. These flexible terms and conditions are exactly what one would expect in such a competitive segment of the market.

2. Verizon Does Not Arbitrarily Restrict the Number of Circuits that Carriers Can Move to Other Providers.

Verizon does not impose arbitrary limits on the number of circuits that carriers can migrate to their own (or other competitors') facilities. Lew Reply Decl. ¶¶ 24-26. Instead, Verizon treats all migrations as projects and negotiates each phase of the migration with the carrier customer, from the start date to the migration intervals. And Verizon commits substantial resources to completing migrations in a timely fashion, in accordance with the terms of the negotiated projects. In 2004, Verizon migrated over **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** special access circuits to competitive providers and, currently, **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** of Verizon's technicians are working to process migration orders. *Id.*

Moreover, any migration delay or limitation could easily be caused by the carrier or end user, not the price cap LEC. Migrations are worked as projects precisely because there is a need for the requesting carrier to perform certain functions to assure the circuit is cut over without mishap. *Id.* Yet, a review of all migrations in Verizon East for the first six months of 2005 reveals that where scheduled work is missed, more than seventy percent of the time the cause is customer or end user delays. *Id.* In short, Verizon is committed to working with all of its customers to coordinate migration projects, optimize the use of resources, and minimize service outages.[19]

IV. THE COMMISSION SHOULD REMOVE OBSTACLES TO THE NEGOTIATION OF COMMERCIAL AGREEMENTS.

A. There Is Widespread Agreement That Price Cap LECs Should Have Greater Flexibility To Enter Individually Negotiated Service Agreements Throughout Their Service Areas.

The existing pricing flexibility framework prevents price cap LECs from offering customized special access terms and pricing throughout their service areas, because the rules only permit LECs to negotiate contracts once certain collocation showings are met and, even then, require that all individualized service arrangements be filed as tariffs. Not surprisingly, Verizon's inability to respond to requests for custom-tailored, region-wide prices, terms, and conditions has not only caused significant frustration among special access customers, but it has prevented Verizon from competing as effectively as possible. *See* Lew Decl. ¶ 54; Bruno Decl. ¶¶ 3, 39.[20]

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[19] Sprint is wrong in claiming that Verizon's nonrecurring coordinated retermination charge of $380 is an obstacle to switching carriers. Sprint 7 n.10. The coordinated retermination charge is nondiscriminatory: it applies whenever a Verizon customer voluntarily asks Verizon to reterminate an existing circuit to a different primary location (*i.e.*, the POP-end of the circuit) served by a different wire center, regardless of whether the affected portion of the circuit remains on Verizon's network or is transferred to another provider. For example, if a carrier has a circuit running from an end user to a primary location served by Wire Center A and wants to reterminate the circuit to a new primary location served by Wire Center B, a coordinated retermination charge would apply whether the circuit is reterminated from one Verizon facility to another Verizon facility, from a Verizon facility to an alternative provider, or from an alternative provider to a Verizon facility. Moreover, carrier customers have the option of avoiding the coordinated retermination charge by foregoing coordination, disconnecting the circuit, and submitting a separate new connect of service order to the new location. Lew Reply Decl. ¶ 26.

[20] SBC noted that its customers express similar frustration. SBC 60 (stating that SBC customers "express frustration at not being able to leverage their wide-ranging business to obtain multi-regional discounts from the price-cap LECs."). In particular, SBC explained that its customers are demanding pricing proposals across larger geographic areas than an MSA and SBC is unable to respond due to regulatory restraints. SBC Casto Decl. ¶ 71.

For example, **[BEGIN CLEC PROPRIETARY]** **[END CLEC PROPRIETARY]** asked Verizon to develop a competitive offer for a SONET ring product in Illinois. Verizon was unable to develop a competitive offer because the specific Illinois MSA did not have pricing flexibility. Verizon did not win this business and can only assume that the potential customer bought the service from another carrier. *See* Lew Reply Decl. ¶ 28. Similarly, **[BEGIN CLEC PROPRIETARY]** **[END CLEC PROPRIETARY]** requested a competitive offer for Intellilight Broadband Transport (IBT) point-to-point service for dedicated transport between collocation arrangements in various wire centers, valued at almost **[BEGIN CLEC PROPRIETARY]** **[END CLEC PROPRIETARY]**. Verizon could not develop a competitive offer for the IBT service because the New Bedford-Fall River and Pittsfield MSAs, where some of the wire centers are located, do not have Phase I or Phase II pricing flexibility. *See id.* ¶ 29.

Driving this point home, major special access customers support giving price cap LECs the ability to provide special access services pursuant to individually negotiated agreements. Sprint, for example (at 11-12), urges the Commission to give ILECs flexibility in every market to negotiate special access contracts, free from Part 69 rate structure rules and regardless of the competitive triggers. Likewise, PAETEC (at 14-15) urges the Commission to give ILECs flexibility "to reduce prices in response to competition," which would provide "increased regulatory stability for all stakeholders" and "eliminate the FCC's administrative burden under the current pricing flexibility rules of making complicated determinations of competitive entry".

See also Ad Hoc 50-51 (ILECs should be permitted unlimited downward pricing flexibility in response to competition); XO 13 (same).[21]

As the record demonstrates, tying flexibility to offer negotiated service arrangements to the amount of collocation in an MSA is not necessary to promote competition or protect consumers; in fact, it has precisely the opposite effect, because it effectively places a floor on special access prices and prevents LECs from responding to customer requests for customized agreements. *See* Taylor Reply Decl. ¶ 54 (because special access is "sold to customers having many different locations ... MSA-based regulatory restrictions make it comparatively more difficult for ILECs to respond to RFPs or negotiate commercial contracts than for their competitors"). In contrast, commercially negotiated contracts free from regulatory restrictions benefit consumers and further competition. Such an outcome is not only in the public interest, but also furthers Congress's goal of creating a pro-competitive, deregulatory framework that reflects "the virtues of negotiated competition." *Verizon N. Inc. v. Strand*, 367 F.3d 577, 585 (6th Cir. 2004). Accordingly, for the same reasons that the Commission recently eliminated the pick-and-choose rule – in order to encourage "the sort of give-and-take negotiations that Congress envisioned" and remove restrictions that "impose[] material costs and delay on both parties and serve[] as a regulatory obstacle to mutually beneficial transactions" – it should permit price cap LECs to negotiate customized service agreements with special access customers throughout their service areas, free from regulatory constraints on price levels and rate structures and without tariffing obligations. *See Review of the Section 251 Unbundling Obligations of*

[21] Some of these parties suggest that downward pricing flexibility only be allowed in conjunction with forced reductions in special access rates. This "have their cake and eat it too" approach is inconsistent with market dynamics and common business practices. A business cannot be compelled to provide services at regulatorily-determined rates and then be expected to compete by reducing rates even further below the artificial level set by regulators.

Incumbent Local Exchange Carriers, 19 FCC Rcd 13494 ¶¶ 12, 13 (2004). During the transition to a fully commercial environment, any residual concerns can be addressed by requiring LECs to continue offering generally tariffed special access services under the existing rules as a backstop.

B. The Phase II Triggers Should Be Refined To Take Into Account Non-Collocated Competitive Alternatives.

The Phase II triggers are substantially underinclusive because they ignore intra- and inter-modal competition from the multitude of providers that do not collocate in the ILEC's wire centers. As a result, Verizon does not have Phase II relief for end user channel terminations in such competitive MSAs as Boston, New York, Philadelphia, Baltimore, Washington, D.C., and Los Angeles. Verizon 29-33; Lew Decl. ¶¶ 24-44. Other commenters made similar showings of non-collocated competition. *See e.g.*, SBC Casto Decl. ¶ 11; Iowa/Valor 18-19 (mid-size ILECs are not eligible for pricing flexibility even though they face competition from facilities-based carriers that do not collocate in the carriers' central offices). Indeed, even Sprint acknowledges (at 10) that "[m]any alternative providers of special access services do *not* collocate in the ILEC end office (for example, a neighboring ILEC that overbuilds its local franchise, or a cable or electric power company that uses its own plant to provide telecommunications services)" (emphasis in original).

The lack of Phase II flexibility in these intensely competitive markets deprives consumers of the benefits of no-holds-barred competition. Accordingly, to the extent the Commission retains the Phase II triggers on a transitional basis, it must revise the required showing to account for facilities-based competition from non-collocating carriers. Specifically, ILECs should be permitted to submit evidence of alternative fiber in the area served by specific wire centers—without regard to whether that fiber is collocated in the relevant wire center—in order to demonstrate *prima facie* compliance with triggers. Verizon 36-38; Verizon Attachment B.

Such non-collocated fiber, just like fiber that is collocated, constitutes "irreversible or 'sunk' investment in facilities used to provide competitive services," *Pricing Flexibility Order* ¶ 79, and thus is a reliable indicator of competition.

Even with such evidence from the ILEC, the Commission will still lack the most complete and direct evidence of the scope of competitive facilities deployment – the network information maintained by the competitors themselves. Accordingly, the Commission should obtain complete network maps from competitors, in order to assure that it has as comprehensive a record as possible. Certainly, any competitor objecting to grant of the petition should be obligated to provide full network maps – for the subject wire centers as well as the remainder of the price cap LEC's region – showing where it does and does not have fiber. In the absence of such persuasive rebuttal evidence, the LEC would be entitled to Phase II relief.

The Commission must reject calls to make the Phase II triggers even harder to satisfy, for example by applying the impairment tests for high-capacity loops and dedicated transport adopted in the *Triennial Review Remand Order* or requiring ILECs to demonstrate that competitors are actually serving a certain percentage of enterprise customers using their own facilities. *See e.g.*, Nextel 21-24; T-Mobile 15-18; WilTel 20-24; AT&T 4; PAETEC 13-16. A more granular showing is inconsistent with the way special access services are procured and provided. In particular, even if competition were lacking in a portion of an MSA where there is appreciable special access demand – and the proponents of more intrusive regulation have provided no evidence, such as their own network maps and lists of buildings served, to enable the Commission to make such a determination – the lack of competitors in parts of an MSA does not diminish competition in the MSA as a whole.

To the contrary, even in the few locations where demand exists but competition has not yet fully developed, Verizon must price competitively because customers have significant leverage and demand discounted rates wherever they take service. Indeed, Verizon's discount plans are available across broad geographic areas, although customers are not required to take service from Verizon throughout the entire area in order to receive a significant discount. Verizon 13-15; Lew Decl. ¶ 88. Customers also can take service under one of Verizon's many circuit-specific plans, which have no volume component and afford substantial discounts even for a single DS1 at a single location. *Id.*

Finally, as noted above in response to the CLECs' request to impose TELRIC pricing on special access, there is no legal basis for utilizing the impairment tests to determine whether pricing flexibility is warranted. Regardless of the legality of those tests (which is being challenged on appeal), they attempt to address a very different inquiry. In particular, the impairment tests are intended to determine whether the lack of access to a particular ILEC network element "poses a barrier or barriers to entry … that are likely to make entry into a market uneconomic" for a "reasonably efficient competitor." *Unbundled Access to Network Elements*, 20 FCC Rcd 2533 ¶ 22 (2005) ("*Triennial Review Remand Order*"). That is, they seek to assess, "on a route-by-route basis," *id.* ¶ 79, whether competitors can deploy their own facilities. The pricing flexibility inquiry, in contrast, is intended to determine whether there is sufficient competition in a geographic area to discipline the ILEC's rates. As the Commission recognized in the *Pricing Flexibility Order* (¶ 142), establishment of the "significant market presence" required to meet the Phase II triggers assures "a competitive alternative for dedicated transport services needed to reach the majority, although not necessarily all, of their long distance customers throughout the MSA, and that almost all special access customers have a competitive alternative." The Commission expressly recognized that this might mean some parts of an MSA might "lack a competitive alternative," but noted that special access customers are "large and sophisticated" and "are not without bargaining power," *id.*, and cautioned that requiring "a competitive alternative for access to each and every end user might give competitors the ability to 'game the system.'" *Id.* ¶ 143.

Most importantly, the Commission explained that requiring a more extensive competitive showing prior to granting Phase II flexibility would be contrary to the public interest:

> We conclude that the costs of delaying regulatory relief outweigh the potential costs of granting it before IXCs have a competitive alternative for each and every end user. The Commission has determined on several occasions that retaining regulations longer than necessary is contrary to the public interest. Almost 20 years ago, the Commission determined that regulation imposes costs on common carriers and the public, and that a regulation should be eliminated when its costs outweigh its benefits. ... The Part 69 rate structure can impose costs on an incumbent LEC by limiting its ability to develop rate structures in response to market forces. Thus, retaining the Part 69 rate structure imposes costs on society by perpetuating inefficiencies in the market for interstate access services. The triggers we adopt for Phase II flexibility are sufficient to ensure that incumbent LECs cannot exercise any remaining monopoly power indefinitely. If any incumbent LEC charges an unreasonably high rate for access to an area that lacks a competitive alternative, that rate will induce competitive entry, and that entry will in turn drive rates down.

Pricing Flexibility Order, ¶ 144. That judgment was sound when made six years ago, and it is even more sound today, when the number and geographic scope of competitive high-capacity networks has expanded greatly. Accordingly, the Commission should reject calls to adopt a more granular set of Phase II triggers.

C. <u>The Commission Should Simplify The Special Access Basket Structure</u>.

The existing service categories and sub-categories in the special access basket inhibit price cap LECs' "ability to compete by offering packages of services in whatever combinations customers want." Verizon 38-39; Taylor Decl. ¶¶ 73-76. Yet these categories and sub-categories advance no offsetting regulatory goal; competition is sufficiently vigorous to assure that ILECs do not shift costs to customer of certain kinds of special access services. Indeed, there is no reason to believe that the services that supposedly are susceptible to such cost-shifting (e.g., voice grade and DS1 offerings) are purchased by a discrete class of customers. Accordingly, to the extent the Commission retains price cap regulation as a transitional backstop measure, it should adopt a single basket to permit ILECs to "restructure rates in response to market forces." Taylor Decl. ¶ 75.

The Commission should reject proposals to disaggregate the special access basket even further, for example by establishing separate categories for end user channel terminations, POP-side channel terminations, and channel mileage. *See e.g.*, Sprint 13-14; Nextel 8-9; Ad Hoc 50; ATX 28-32. In the face of declining prices, increasing output, and the introduction of more flexible service offerings, there is no justification for imposing additional constraints on the ability of price cap LECs to adjust rates in response to market forces. Moreover, mandating a proliferation of service bands would be inconsistent with the manner in which services are sold, rendering it "difficult for ILECs to put together responses to RFPs or to negotiate price reductions." Taylor Reply Decl. ¶ 58. Consequently, granting the CLECs' request would "protect[] competitors rather than competition," *id.* ¶ 54, and "eviscerate the emerging price competition that produces consumer welfare gains in the first place." *Id.* ¶ 53.

D. <u>The Commission Should Deregulate Packet-Switched Services.</u>

The Commission should remove any price regulation of highly competitive packet-switched services. Verizon 39. The Commission already has found that there is widespread competition for packet-switched services and that competitors are "actively deploying" packet

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switches. *Triennial Review Order*, ¶ 538. Moreover, in the pending *Broadband Title I* and *Broadband Title II* proceedings, the Commission is considering whether such services should be subject to Title II regulation at all. Likewise, Verizon and other BOCs have filed petitions for forbearance demonstrating that Title II regulation is not necessary to assure just and reasonable rates or protect consumers, and that forbearance from such regulation would serve the public interest. And, as Chairman Martin recently noted, the Supreme Court's *Brand X* decision "paves the way for the FCC to place telephone companies on equal footing with cable providers. We can now move forward and remove the legacy regulation that reduces telephone companies' incentives to provide broadband." *See* Chairman Kevin J. Martin, *Broadband*, WALL ST. J., July 7, 2005, A12; *see also* FCC News Release, "Chairman Kevin J. Martin's Announcement Regarding the Supreme Court's Decision in *Brand X*," June 27, 2005. Against this background, the Commission should not impose any new regulations on packet-switched services, and it should exclude these services from price regulation while finalizing its deregulatory broadband regulatory framework.

No commenter claimed that packet-switched services are not competitive or warrant additional regulation. To the contrary, the only other commenter addressing packet-switched services, SBC, urged the Commission to eliminate all pricing regulation and apply Phase II pricing flexibility to these services "immediately for all areas, nationwide" due to vibrant competition. SBC 59. In short, the record is uncontested that packet-switched services are competitive and further deregulation is appropriate.

V. **THERE IS NO BASIS FOR COMPELLING EITHER INTERIM OR PERMANENT REDUCTIONS IN SPECIAL ACCESS RATES.**

The pricing and competitive evidence establish that special access rates are reasonable, and, as the Commission anticipated when it adopted pricing flexibility, competition has driven special access rates down. Moreover, competition is increasing both from CLECs and from intermodal alternatives such as cable companies and wireless service providers. Therefore, there is no legal, policy, or factual basis for abandoning pricing flexibility and mandating reductions in special access rates either immediately or on a going-forward basis.

A. There Is No Evidence To Support Reinitializing Price Cap Rates.

As the Commission has acknowledged, its "authority to prescribe rate reductions under Section 205(a) depends upon a finding that current rates are or will be unreasonable." *LEC Price Cap Order*, ¶ 235. Yet there is no evidence that current rates either are unreasonable or will become so; in contrast, there is substantial evidence that special access rates have been decreasing as a result of competition and that competition is continuing to expand. Accordingly, there is no lawful basis for reinitializing special access rates.

In addition to failing to provide any credible evidence that special access rates are unreasonable, commenters advocating reinitialization ignore the other legal and policy problems with their proposal. Price cap regulation and pricing flexibility were adopted to avoid the pitfalls of rate-of-return regulation and move LECs closer to market-driven incentives to improve efficiency, invest in new facilities, and introduce new services. Reinitializing rates would destroy the benefits of the last twelve years of incentive-based regulation by punishing LECs for responding to the precise incentives that the Commission sought to create. And, it would deprive the Commission of the ability to use incentive-based regulation in the future, because neither regulated firms nor investors will trust the Commission to follow through on its commitments.

Further, even if the Commission were to reinitialize rates, there is no basis for using 11.25%.[22] As the Commission acknowledged in the NPRM, the use of 11.25% would go "well beyond restoring the rate levels that would have been in place had the Commission never adopted the pricing flexibility rules that have been challenged." NPRM ¶ 130. This supposed "benchmark" was instituted in 1991 based on data from prior years. NPRM ¶ 60. Although there was only minimal competition at that time, the telecommunications market generally, and special access services in particular, are now highly competitive. In this new landscape, 11.25% would under-compensate investors for market risks. Moreover, the Commission cannot just reinitialize special access rates without considering the other interstate services ILECs provide. If the Commission determines the Verizon's 2004 ARMIS-calculated 31.48% for special access must be lowered, then the 1.79% rate of return earned by Verizon on switched access services is unconstitutionally confiscatory and must be raised, not to 11.25%, but to a higher rate that accurately reflects competition in today's market.

If there were a basis to reinitialize rates, which there is not, the Commission would need to determine the appropriate rate of return for a competitive market and could not rely on the low percentages that were acceptable prior to competition. As some commenters recognize, *see, e.g.* Ionary 4-5, the Commission would need to conduct a detailed cost study to reinitialize rates. This would take the Commission full circle to the rate of return approach it rejected more than a decade ago. Price cap regulation was "intended to avoid the perverse incentives of rate-of-return regulation in part by divorcing the annual rate adjustments from the performance of each individual LEC." NPRM ¶ 10. The Commission intended that after the CALLS plan,

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[22] Nor, as explained in section II.B.3, above, could the Commission lawfully reinitialize special access rates at TELRIC levels, absent a finding of impairment pursuant to Section 251(d)(2) of the Act.

"deregulation of access charges for price cap LECs would be the next logical step." NPRM ¶ 15. Given the vast increase in competition, returning to rate of return regulation, with its accompanying disincentives to efficiency and constant litigation, cannot be justified under any circumstances.

B. There Is no Basis for Increasing the Productivity Factor, Adopting a "g" Factor, or Reinstituting Sharing.

For similar reasons, the Commission must reject requests for a productivity factor, "g" factor, and reinstitution of sharing. Each of these mechanisms is intended solely to drive down special access rates, but there is no basis for determining that existing rates, which are continuing to decline under pricing flexibility, are unjust and unreasonable.

Productivity factor. Several commenters advocate adoption of a special access-specific productivity factor, either at the 5.3% level used (as one of three options) back in 1995 or at whatever level would produce an ARMIS-calculated rate of return of 11.25%. *See, e.g.*, PAETEC 17-18, Ad Hoc 44-47. These commenters ignore both the demonstrated difficulty of adopting even a company-wide productivity factor that can withstand judicial scrutiny and the inherent arbitrariness of any service-specific productivity factor.

The Commission has acknowledged that there is no widely accepted way to calculate productivity gains. Any attempt to revive this issue would lead to the same endless regulatory proceedings and litigation that never produced a judicially acceptable X factor and that spawned the development of the CALLS plan in the first instance. The 5.3% proposed by some commenters was developed based on a record that is now more than ten years old and, far from receiving judicial endorsement, was upheld only as an interim measure and only as one of three choices open to carriers.[23] Further, no commenter has provided any evidence that the telecommunications industry is still more productive than the U.S. economy as a whole. Indeed, increased competition almost certainly deprives ILECs of the ability to outperform the general economy, since their overall output is declining. Taylor Reply Decl. ¶ 60.

Even if these hurdles could be overcome on a company-wide basis, setting a service-specific X factor is inherently arbitrary. Productivity factors are company-wide measurements; they cannot be calculated for single jurisdictions or services. *Price Cap Performance Review of Local Exchange Carriers*, ¶ 110. Devising a special access-specific X factor would require the Commission to measure the growth of inputs for that service alone. Yet many of the same facilities and resources that are used in providing special access service are also used to provide other services, so such a calculation is impossible. Taylor Decl. ¶ 66.

"g" factor. Commenters suggesting that the Commission should adopt a "g" factor, *see* Ionary 9; PAETEC 18, fail to acknowledge that (1) such a factor inevitably would double-count productivity gains, and (2) the "g" factor is inapplicable in the special access context. Taylor Reply Decl. ¶ 62. This factor was applied to common line services because carrier common line charges recovered non-traffic sensitive costs on a traffic-sensitive basis. In the case of special

[23] After determining that "there [was] an insufficient record to choose a long-term methodology for computing the X-Factor." *See Price Cap Performance Review for Local Exchange Carriers,* CC Docket No. 94-1, First Report and Order, 10 FCC Rcd 8961, ¶ 144 (1995) (1995 Price Cap Review Order), the Commission established three interim X factors for the "1995 annual access tariff filings," (4.0, 4.7, and 5.3 percent) based on pre-price cap (pre-1990) data. On appeal, the court found only that the use of these three factors was a reasonable *interim* measure for 1995. *Bell Atlantic Tel. v. FCC,* 79 F.3d 1195, 1203 (D.C. Cir. 1996). Indeed, the D.C. Circuit later invalidated the Commission's adoption of a subsequent 6.0 percent X factor because the FCC used "irrational" methodologies. *See USTA v. FCC,* 188 F.3d 521, 526 (D.C. Cir. 1999). That Court also invalidated the same consumer productivity dividend component of the X factor that was upheld in *Bell Atlantic*. In so doing, the Court explained that its *Bell Atlantic* decision evaluated solely the FCC's *interim* 1995 X factor rule. *Id.* at 527.

access, non-traffic sensitive costs are recovered on a non-traffic sensitive basis, so there is no windfall to the ILEC.

Sharing. Some commenters suggest that the Commission should reimpose a sharing mechanism. New Jersey 7; PAETEC 22-23, BT Americas 1. For the same reasons that the Commission should not reinitialize rates, it should not reintroduce sharing. The Commission eliminated sharing in 1997 because it deprived ILECs and consumers of the full benefits of the lower prices and improved efficiency that incentive regulation was designed to provide. *NPRM* ¶ 44; *Price Cap Performance Review for Local Exchange Carriers*, 10 FCC Rcd 8961 ¶ 191 (1995). If sharing were once again required, the Commission would transform price cap regulation into "rate of return regulation in disguise." Taylor Reply Decl. ¶ 64. Reintroducing sharing thus would undermine the Commission's efforts at incentive-based regulation now and in the future.

VI. THERE IS NO BASIS FOR IMPOSING A FRESH LOOK REQUIREMENT.

Some parties urge the Commission to impose a "fresh look" period, during which customers of special access term discount plans or contract tariffs could terminate or renegotiate their service arrangements without liability, in order to benefit from any new rules adopted in this proceeding. *See* PAETEC 20-22; ATX *et al.* 39; Time Warner Telecom 23-24. There is no policy or legal basis for granting this request.

As the Commission recognizes, fresh look is an "extraordinary remedy" available only in "limited circumstances" not present here. *Direct Access to the INTELSAT System*, 14 FCC Rcd 15703, ¶ 118 (1999) ("*INTELSAT Direct Access Order*"). Indeed, the FCC has emphasized that fresh look is a "market disrupting remedy" that is granted only on "very rare" occasions. *Review* *of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd 16978 ¶ 698 (2003) ("*Triennial Review Order*").

The Commission has created a high hurdle for customers seeking fresh look rights. In particular, in "applying the fresh look doctrine," the Commission "consider[s]: (1) whether the entity holding the long-term contracts has market power and has exercised that power to create long term contracts to 'lock up' the market in such a way so as to create unreasonable barriers to competition; and (2) whether the contractual obligations can be nullified without harm to the public interest." *INTELSAT Direct Access Order*, ¶ 119. The allegations raised by fresh look proponents fall far short of this showing.

First, there is no evidence that ILECs have market power over special access services. *See* Sections II and III, *supra*. To the contrary, rates have been declining even in the face of rapidly growing demand, and there are numerous intra- and inter-modal competitors wherever there is appreciable demand for special access services. Consequently, no single carrier could erect barriers to competition, whether through the use of discount plans and contract tariffs or otherwise. Customers could simply choose other carriers or opt not to enter into a discount plan or contract tariff at all. Rather, customers freely enter into such arrangements in order to receive benefits, such as lower prices and customized terms, just as the Commission anticipated in the *Pricing Flexibility Order*.

Moreover, these arrangements do not "lock up" customers. As Verizon established in its opening comments (at 16-17; *see also* Lew Decl. ¶¶ 95-98), the termination penalties in its discount plans and contract tariffs are reasonable and supported by Commission precedent. Accordingly, claims that ILECs "force CLECs" into contracts with "significant penalties," PAETEC 21, are simply wrong.